volume and/or term commitments."[89] Verizon further stated that "the fact that carriers are successful serving end-users using special access purchased at these prices is conclusive proof that they are not impaired in their ability to compete."[90] That will be particularly true for the merged entities because, as noted above, AT&T and MCI qualify for some of the deepest discounts off each ILEC's special access "rack rates" based on the size of their demand for high-capacity facilities.

In addition to substantial discounts arising from their ability to commit to large term and volume commitments, AT&T and MCI possess additional cost advantages that are not available to other carriers. Because of the size of even the pre-merger AT&T and MCI, they can deploy multiple POPs in a local exchange area, with the result that their average mileage-sensitive access rates are significantly less than those of their competitors.[91] This is not to suggest that the ability to deploy multiple POPs is itself anti-competitive, but this ability is one more vehicle through which the MegaBOCs will differentiate themselves from all of their competition – ensuring that any "discrimination" between them and their competitors caused by grant of the forbearance requested here is not "unreasonable" within the meaning of the Act.

Second, as a legal matter, treating the MegaBOCs differently with respect to the Commission's circuit-flipping rules would not run counter to the requirements of section 10(a)(1). That section prohibits only *unjust or unreasonable* discrimination – a standard that, according to the Commission, is far less exacting than prohibitions against *all*

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[89] *Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Reply Comments of Verizon at 88 (filed Oct. 19, 2004).

[90] *Id.*

[91] *See, e.g.*, AT&T Global Network Map, *available at* www.att.com/globalnetwork/network_map.html (mapping AT&T's numerous POPs).

discrimination, such as the non-discrimination obligations in section 252(c)(2)(C) applicable to interconnection.[92] Treating the resource-rich MegaBOCs *differently* from other carriers would be consistent with this relaxed standard, and the Commission should therefore forbear from applying the circuit-flipping rules to them.

2. Special Access Rates Are Just and Reasonable, and not Unjustly or Unreasonably Discriminatory

As noted above, the merging companies already pay special access rates under ILEC tariffs, and those rates are just and reasonable and not unjustly or unreasonably discriminatory. Forbearing from the requirement that ILECs convert MegaBOC-leased special access circuits would merely require those carriers to continue paying tariffed rates in the future. Accordingly, enforcement of the circuit-flipping rules is not necessary to ensure that the MegaBOCs' charges for the circuits are not unjust or unreasonable, or unjustly or unreasonably discriminatory. (For the same reason, it would defy logic to conclude that the MegaBOCs would be "impaired" if, following the mergers, they were to continue to lease circuits at the same special access rates they already pay to provide service to existing customers.)

Qwest, like other ILECs, must submit tariffs containing the rates, terms, and conditions of its interstate special access services for review by the Commission, except in those areas where Phase II pricing flexibility has been granted.[93] (Phase II areas are

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[92] *See Local Competition Order,* 11 FCC Rcd. at 19531-33 (¶¶ 312-316).

[93] In 1999, the Commission established a two-phase pricing flexibility regime expanding incumbent carriers' freedom to structure pricing of their tariffed special access and dedicated transport offerings. *See Access Charge Reform,* Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd. 14221 (1999) ("*Pricing Flexibility Order*"), *aff'd, WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001). Under this regime, pricing flexibility relief depends on a demonstration that competitors have made sufficient sunk investments in facilities within an MSA as measured by the extent of competitive fiber collocation and use of competitive transport. *See id.* at 14261-65 (¶¶ 75-80). The triggers for various specific varieties of special access differ, but generally satisfaction of the "Phase 2" triggers requires that one or more competitors have collocated and use competitive transport in a predetermined proportion of the

subject to a comparable test set forth by the Commission.[94]) Moreover, Qwest files these tariffs pursuant to section 204(a)(3) of the Act, which provides that the tariffs are "deemed lawful" unless the Commission takes action within fifteen days of filing.[95] Thus, the special access rates charged by Qwest and other ILECs have already been deemed just and reasonable as a matter of law.[96]

The Commission has held that it is inappropriate to assume that rates and practices within the Commission's jurisdiction (such as special access rates) violate the Commission's orders. To the contrary, the Commission starts with a presumption that telecommunications carriers comply with its rules and regulations when setting rates, and it provides parties with an opportunity for relief if that presumption is faulty.[97] Thus, requiring SBC and Verizon to pay tariffed special access rates instead of TELRIC-based UNE rates is, by definition, just and reasonable.

LEC's wire centers in the MSA at issue, or in wire centers accounting for a specific portion of the LEC's special access revenues in the MSA. *See id.* at 14296-301 (¶¶ 141-52). An incumbent LEC subject to "Phase 2" pricing flexibility may offer some services free from the Commission's price cap rules and price cap rates, and may change its rates and terms on one day's notice. *See id.* at 14301-03 (¶¶ 153-57). A LEC enjoying "Phase 1" pricing flexibility may offer contract tariffs and volume and term discounts for the services subject to such flexibility on one day's notice, but must maintain their generally available, price-cap constrained tariffed rates. *See id.* at 14232-41 (¶¶ 19-33); *see also* 47 C.F.R. § 69.727(b).

[94] The Commission is currently examining this test in a pending rulemaking. *See Special Access Rates for Price Cap Local Exchange Carriers; AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services,* Order and Notice of Proposed Rulemaking, 20 FCC Rcd. 1994 (2005). The FCC's forthcoming rules in this area should be presumed to be reasonable for purposes of evaluating this Petition.

[95] 47 U.S.C. § 204(a)(3).

[96] Of course, in the event that a customer felt that Qwest's special access rates were unreasonable, it could file a complaint pursuant to Section 208 of the Act. The fact that these tariffs were deemed lawful, while it would preclude damages based on a claim that the rates were unreasonable, would not preclude the Commission from finding to the contrary on a going-forward basis and requiring the filing of a new or revised tariff that was determined to comply with the Act.

[97] *See Section 271 Forbearance Order,* 19 FCC Rcd. at 21509 (¶ 26, n.84) ("...we should not presume, nor do we have any evidence, that the BOCs will act in an unreasonable or unreasonably discriminatory manner without evidence of such actions. To the extent our predictions ... are incorrect, carrier can file appropriate petitions with the Commission and, of course, the Commission has the option of reconsidering this forbearance ruling.").

In addition, both SBC and Verizon have assured the Commission that their special access rates are just and reasonable. Therefore neither of them could plausibly assert that the special access rates that Qwest charges AT&T and MCI are not also just and reasonable. SBC's comments in the *Special Access NPRM* proceeding, for instance, asserted that "[s]ince the Commission adopted its pricing flexibility rules, the average true price to the customer of SBC's special access services has dropped."[98] Likewise, Verizon has argued that "Special Access pricing is competitive and prices paid by customers have declined."[99]

C. Enforcement of the Circuit-Flipping Rules is not Necessary for the Protection of Consumers.

As explained in Dr. Wilkie's attached Declaration, consumers are not likely to receive any benefit from requiring LECs to convert the MegaBOCs' circuits post-merger. Equilibrium prices in a particular market are set by the marginal costs of the highest-cost firms. Accordingly, if *all* firms supplying services to the enterprise market could flip circuits, then the equilibrium prices – the prices consumers pay – would indeed be lower.[100]

The MegaBOCs will thus be "inframarginal" suppliers of services in the enterprise market. As Dr. Wilkie explains in his Declaration, "an inframarginal supplier is a firm whose marginal costs of production are lower than the marginal production costs

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[98] *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, Comments of SBC Communications Inc. at 21 (filed June 13, 2005); *see also Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Reply Comments of SBC Communications Inc. at 46-47 (filed Oct. 19, 2004).

[99] Verizon Dec. 7, 2004 ex parte, attachment at 5.

[100] *See* Wilkie Declaration ¶ 27.

of the highest-cost (or 'marginal') suppliers."[101] Their sheer size gives them huge cost advantages even without considering their ability to gain an additional regulatory advantage by using the circuit-conversion rules to flip their existing special access circuits. As Dr. Wilkie explains, circuit flipping by only inframarginal suppliers like the MegaBOCs merely lowers *their* costs without lowering equilibrium prices.[102] The net result would be a revenue transfer from input suppliers of special access services (*e.g.*, Qwest) to inframarginal suppliers in the enterprise market (*e.g.*, the MegaBOCs), with little or no increase in consumer surplus.[103] Indeed, the merging parties have a track record of absorbing such windfalls without passing them through to consumers. As Dr. Wilkie explains in his Declaration, the Commission has repeatedly lowered interstate switched access charges since the AT&T divestiture, but – despite commitments to do so – the major long-distance carriers (including AT&T and MCI) have not passed the reductions on to consumers.[104]

Requiring Qwest and other LECs to convert the MegaBOCs' circuits would, moreover, reinforce the MegaBOCs' ability and incentive to engage in tacit collusion and *not* to compete in each other's territories, contrary to their rhetoric in the merger dockets.[105] As Dr. Wilkie explains, the present value of the MegaBOCs' earnings from collusion greatly exceeds the present value of their earnings under competition (even

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[101] *Id.* ¶ 25.

[102] *See id.* ¶¶ 26-28.

[103] *See id.* ¶ 28.

[104] *See, e.g., id.* ¶ 29.

[105] *See, e.g., Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Joint Opposition of Verizon Communications Inc. and MCI, Inc. to Petitions to Deny and Reply to Comments at 22-23 (filed May 24, 2005); *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorization from AT&T Corp. to SBC Communications Inc.*, Joint Opposition of SBC Communications Inc. and AT&T Corp. to Petitions to Deny and Reply to Comments at 131-140 (filed May 10, 2005).

accounting for "one-shot" profits for cheating under competitive conditions).[106] Enforcing the circuit-flipping rules in this context would thus "yield supra-competitive prices" over time.[107]

D. Section 10(d) does not Bar Forbearance Because the Requirements of Section 251(c) Have Been Fully Implemented.

Section 10(d) does not prevent the Commission from granting the forbearance sought by Qwest because the FCC has already determined that the requirements of section 251(c) have been "fully implemented" in Qwest's region. Specifically, in granting section 271 relief in all of Qwest's states, the Commission found that Qwest had "fully implemented the competitive checklist" of Section 271.[108] Because the checklist items directly overlap with Section 251(c)(3) of the Act, which is at issue here, the FCC's express finding of compliance with the Section 271 checklist items is dispositive of Section 251(c) implementation as well.[109] Indeed, Verizon itself has explained to the Commission[110] that the competitive checklist incorporates by reference all applicable

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[106] *See* Wilkie Declaration ¶¶ 35-43.

[107] *Id.* ¶ 43.

[108] *See Section 271 Forbearance Order,* 19 FCC Rcd. at 21503 (¶ 15) ("because the BOCs have obtained section 271 authority in all of their states, we find that the checklist requirements of section 271(c) are 'fully implemented' for purposes of section 10(d) throughout the United States."). Section 271(c)(2)(B)(ii) required Qwest to implement "nondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1)."

[109] *See Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area,* WC Docket No. 04-223, Qwest ex parte, attachment at 3-6 (filed July 25, 2005) ("Qwest Omaha ex parte"); *see also Application by Qwest Communications International Inc., for Authorization To Provide In-Region, InterLATA Services in Minnesota,* Memorandum Opinion and Order, 18 FCC Rcd. 13323, 13350 (¶ 50) ("Qwest complies with the requirements of [checklist item 1]."); *id.* at 13329 (¶ 12) ("Qwest has satisfied the requirements of checklist item 2."). The same analysis is applicable to resale. The FCC has found that Qwest is providing "[t]elecommunications . . . available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3)," and that Qwest's performance "satisfied the requirements of this checklist item." *Id.* at 13353-54 (¶ 58).

[110] *See Verizon Petition for Forbearance, Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* CC Docket No. 01-338, Verizon ex parte, attachment at 3 (filed Oct. 24, 2003) ("[T]he Commission has already found, in approving section 271 applications for 49 states and the District of Columbia, that the Bell companies have in fact 'fully implemented the competitive checklist.'").

"requirements of section[] 251(c)."[111] It plainly follows that the Commission also found that, in Qwest's states, those requirements have been "fully implemented."

It is important to note that Qwest does not maintain that its Section 251(c) obligations automatically go away once Section 271 authority has been granted. To the contrary, the statutory scheme was established solely to prevent BOCs from circumventing the implementation of Sections 251(c) and 271 through forbearance. Thus, before the statutory forbearance tests outlined in Sections 10(a) and (b) of the Communications Act are effective and can be used in the case of a rule required by Sections 251(c) or 271, those provisions must first have been "fully implemented." Once they have been fully implemented, the affected BOC can seek forbearance from its requirements based on the same sort of showing as would be necessary in any forbearance proceeding.[112]

[111] *See* 47 U.S.C. § 271(c)(2)(B)(ii).

[112] *See* Qwest Omaha ex parte at 6.

V. CONCLUSION

For the foregoing reasons, Qwest petitions the Commission to forbear from enforcing its circuit-flipping rules to the extent they would require Qwest and other LECs to convert the post-merger MegaBOCs' special access circuits to UNE pricing.

Respectfully submitted,

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V. CONCLUSION

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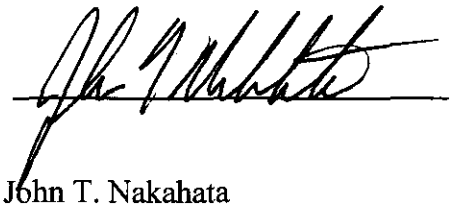

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October 4, 2005

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
Qwest Communications International, Inc.	)	WC Docket No. _____
PETITION FOR FORBEARANCE From Enforcement of the Commission's Circuit-Conversion Rules as They Apply to Post-Merger Verizon/MCI and SBC/AT&T	)	
(Petition for Forbearance Under 47 U.S.C. § 160(c))	)	

DECLARATION OF SIMON WILKIE

I. INTRODUCTION

1. My name is Simon J. Wilkie. I am the Executive Director of the Center for Communications Law and Policy at the University of Southern California. Previously, I was an Assistant Professor and Senior Research Associate in Economics at the California Institute of Technology. Prior to joining the faculty at the California Institute of Technology, I was a Member of Technical Staff at Bell Communications Research. I have also held the positions of Affiliated Scholar of the Milken Institute and Visiting Assistant Professor at Columbia University. Over the past fifteen years, my academic research has focused on the areas of mechanism design, regulation, and game theory. I specialize in analyses involving industrial organization, regulation, public finance, and the design of institutions, with particular applications to the economics of telecommunications and network industries. I have conducted economic research and prepared testimony on a variety of antitrust and regulatory issues in a number of industries, including the telecommunications industry. I have also consulted on matters involving mergers and acquisitions in the satellite and the cable industries, and on issues related to local service and wireless competition. My research has appeared in a number of academic journals, including the *Review of Economic Studies, Journal of Economics and Management Strategy,* and the *Journal of Industrial Economics*. I received a Bachelor of Commerce degree in Economics from the University of South Wales, Australia, and my M.A. and Ph.D. degrees in Economics are from the University of Rochester.

2. From 2002 to 2003, I served as Chief Economist at the Federal Communications Commission ("FCC" or "Commission"). In that capacity, I oversaw the economic analysis performed by the Commission staff and advised the Chairman and Commissioners on issues

involving economic analysis. Major items before the Commission during my tenure included the EchoStar/DirecTV transaction, the Comcast/AT&T Broadband transaction, the Triennial Review of Unbundling Obligations, and the Biennial Review of Media Ownership rules.

3. I have been asked by counsel for Qwest Communications International, Inc. ("Qwest") to investigate and comment upon the likely impact of certain of the Commission's rules in the event that the currently proposed acquisitions of AT&T Corporation and its subsidiaries ("AT&T") by SBC Communications, Inc. ("SBC") and of MCI, Inc. and its subsidiaries ("MCI") by Verizon Communications, Inc. ("Verizon") are consummated. Specifically, I have been asked to examine the FCC's rules governing the process by which a telecommunications carrier procuring circuits from an incumbent local exchange carrier ("ILEC") under tariffed special access rates can convert the purchase of those circuits to unbundled network element ("UNE") rates. It has been alleged that this process of converting circuits from special access to UNE rates – colloquially known as "flipping" in the telecommunications industry – will provide the combined SBC/AT&T and Verizon/MCI with the incentive and ability to harm competition in certain markets for local telecommunications services.[1] I examine issues relevant to the allegation and determine what, if any, potential harms to competition are likely to result following the mergers as a consequence of the Commission's circuit flipping rules.

4. As discussed in greater detail below, I find that the acquisition of AT&T and MCI (as the nation's largest purchasers of special access and the leading facilities-based competitors to SBC and Verizon for certain local telecommunications services) by SBC and Verizon (as the nation's leading sellers of special access and largest incumbent regional providers of local

service) creates a unique situation with respect to circuit flipping that was likely not conceived when the FCC implemented its rules. The mergers facilitate the routing of local traffic onto the networks of AT&T and MCI, making these firms' leased special access circuits especially eligible for flipping. As a consequence, AT&T and MCI potentially could reduce the cost of their existing networks significantly. However, as shown below, if post merger these two carriers are inframarginal suppliers of the relevant telecommunications services, their windfall cost reductions from circuit flipping will likely have little or no effect on consumer prices.

5. Conversely, the circuit flipping may cause several distinct, adverse competitive effects. First, I conclude that the potential to flip AT&T's and MCI's special access circuits to much lower UNE rates will provide SBC and Verizon, following the mergers, with another effective tool for use in sustaining and enhancing tacit collusion between one another. Second, the unusual situation of the post-merger SBC and Verizon will provide these firms with the incentive and ability to punish pro-competitive actions taken within their home regions by Qwest and other carriers, and may allow SBC and Verizon to use the FCC's circuit conversion rules as a tool to discourage new entry in markets for local telecommunications services. Finally, I find that the large-scale flipping of AT&T and MCI circuits to UNE rates made possible by the mergers has the potential to eliminate or diminish severely incentives for any promised out-of-region, facilities-based investment by SBC or Verizon.

6. The remainder of this Declaration is organized as follows. In Section II, I briefly summarize the FCC's rules governing the conversion of special access circuits to UNE rates and discuss how the rules potentially apply to AT&T and MCI. Section III then examines the implications of the Commission's circuit flipping rules in light of the proposed mergers. In

[1] *See* Petition for Forbearance, *Qwest Communications International, Inc. Petition for Forbearance from Enforcement of the Commission's Circuit-Conversion Rules as They Apply to Post-Merger Verizon/MCI and*

particular, I assess the claim that AT&T and MCI, by virtue of both their size and their acquisition by the leading incumbent local carriers, stand to benefit disproportionately from the ability to convert special access circuits to UNE rates. In Section IV, I discuss the potential harms to competition that are likely to arise as a consequence of this disproportionate benefit accruing to AT&T and MCI and to their purchasers. Specifically, I demonstrate that competition – not just individual competitors – is likely to be harmed as the circuit flipping rules provide the post-merger SBC and Verizon with the incentive and ability to (1) sustain and enhance tacit collusion between one another; (2) discourage competition in local telecommunications by new entrants or out-of-region carriers; and (3) diminish incentives for facilities-based investment nationwide. Section V presents my concluding remarks and certain recommendations for the Commission to consider.

II. FCC RULES REGARDING "FLIPPING" OF SPECIAL ACCESS TO UNE RATES

A. Summary of the FCC's Circuit Flipping Rules

7. In its August 2003 *Triennial Review Order* ("TRO") regarding the unbundling requirements of incumbent local exchange carriers, the FCC declined to adopt specific rules governing the conversion of wholesale services such as special access to UNEs or UNE combinations.[2] The Commission believed that ILECs and requesting competitive carriers had "an incentive to ensure correct payment for services rendered," were "bound by duties to negotiate in good faith," and could thus establish on their own "any necessary procedures to

SBC/AT&T, WC Dkt No. _____ (F.C.C. Oct. 4, 2005).

[2] *See* Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Dkt No. 01-338, 18 F.C.C. Rcd 16978 (Aug. 21, 2003), at ¶ 585 (hereinafter "FCC Triennial Review Order").

perform conversions with minimal guidance from the FCC."[3] While the Commission noted that CLECs seeking to convert tariffed incumbent LEC services to UNEs had to meet whatever "eligibility criteria that may be applicable," it did not list specific criteria for conversion eligibility other than to say that the particular network element at issue had to be "available as a UNE pursuant to our impairment analysis."[4] In March of 2004, this position was upheld by U.S. Court of Appeals for the District of Columbia Circuit.[5]

8. Beyond the impairment test, however, the FCC has also observed that, to be eligible for conversion from special access to UNE rates, a particular circuit has to be eligible for treatment as a UNE generally. In other words, if a similarly situated circuit newly procured from the ILEC is not available via UNEs, then an existing special access circuit of the same situation likewise is not eligible for conversion to UNE rates. Recently, the FCC has provided additional guidance regarding what special access circuits are not eligible for conversion to UNEs. Specifically, the Commission determined in its *Triennial Review Remand Order* ("TRRO") of February 2005 that mobile wireless services and long-distance services carriers seeking to provide such services can not be considered impaired without access to facilities leased as UNEs from the ILEC.[6] Concluding that "whatever incremental benefits could be achieved . . . by requiring mandatory unbundling in these service markets would be outweighed by the costs of requiring such unbundling," the Commission thus denied access to UNEs "for the exclusive

[3] FCC Triennial Review Order, at ¶ 585.

[4] FCC Triennial Review Order, at ¶ 586.

[5] *United States Telecom Association v. Federal Communications Commission et al.*, 359 F.3d 554, 593 (D.C. Cir. Mar. 2, 2004).

[6] *See* Order on Remand, *Unbundled Access to Network Elements*, WC Dkt No. 04-313 (F.C.C. Feb. 4, 2005), at ¶¶ 34-36 (hereinafter "FCC Triennial Review Remand Order").

provision of mobile wireless services and long distance services."[7] That is, circuits used for the exclusive carriage of interexchange or wireless traffic can not be leased from the ILEC as UNEs. This determination was based on the structure of competition in these markets before the currently proposed mergers.

9. When portions of the TRO were returned to the Commission on remand, various Regional Bell Operating Companies ("RBOCs") – including both SBC and Verizon – argued that the FCC should change its rules to prohibit the conversion of tariffed ILEC services to UNEs entirely.[8] The FCC rejected these arguments and explicitly declined to adopt an "across-the-board prohibition on conversions."[9] In explaining its decision, the FCC confirmed that its existing unbundling framework prohibited requesting carriers from obtaining UNEs exclusively to provide service in end user markets that are already "sufficiently competitive" without access to UNEs.[10] In particular, the Commission highlighted that its existing rules already "prevent the use of UNEs – and therefore also prevent the conversion of special access circuits to UNEs – where carriers would use them exclusively to provide long distance service or mobile wireless service."[11]

10. In summary, the FCC has not implemented specific rules or procedures governing the conversion of facilities procured via special access to UNEs. Instead, it has confirmed that

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[7] FCC Triennial Review Remand Order, at ¶¶ 34, 36 (internal citations omitted). The Commission declined at the time to make a similar determination for other categories of service.

[8] *See* FCC Triennial Review Remand Order, at ¶ 229.

[9] FCC Triennial Review Remand Order, at ¶¶ 229-232.

[10] FCC Triennial Review Remand Order, at ¶ 29. Other reasons given by the FCC against prohibiting conversion of special access circuits to UNEs were (1) that "a prohibition on conversions would be inconsistent with our determination . . . that the availability of tariffed incumbent LEC services does not foreclose access to UNEs" and (2) that a "'no conversions' rule would require us to evaluate the relationships between and among a series of distinct transactions between a competitor and an incumbent LEC," which the Commission found burdensome. *Id.* at ¶¶ 231-232.

[11] FCC Triennial Review Remand Order, at ¶ 230.

such conversions are permissible so long as the circuit to be flipped from special access to UNE rates is eligible for treatment as a UNE. Detailed eligibility criteria have not been set forth, although the Commission has limited the instances in which UNEs are available. In order for a carrier seeking to convert a special access circuit procured from the ILEC to UNE treatment, the carrier must satisfy the conditions of the Commission's impairment test, and it must not use the circuit exclusively to provide long-distance or wireless services. Beyond this, other eligibility conditions may apply for the conversion of particular circuits, but the FCC has not specified additional criteria that apply universally.

B. The Flipping Rules Disproportionately Impact AT&T and MCI in the National Long-Distance and Data Markets

i. AT&T and MCI are the Largest Purchasers of Special Access

11. AT&T and MCI are the nation's leading interexchange carriers, and the firms are also two of the largest providers of voice and data services to large businesses. For instance, as of year-end 2003 (the most recent period for which the FCC has reported data), AT&T and MCI together accounted for half of all toll service revenues in the U.S., with shares of 30.0 percent and 20.8 percent, respectively.[12] According to surveys of major enterprise businesses conducted by Bernstein Research, furthermore, AT&T and MCI are generally regarded "as the only two providers that had the global reach and breadth/flexibility of solutions required to service large multinational corporations," which contributes to the fact that these carriers have collectively retained a much larger share of long-distance voice and data services to enterprises.[13] Bernstein

[12] Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Trends in Telephone Service* (June 21, 2005), at Table 9.6.

[13] Jeffrey Halpern, Bernstein Research, *U.S. Telecom: Superior Growth Prospects Market a Key Battleground for U.S. Service Providers* (Jan. 6, 2005), at 7.

Research estimates that, for 2004, AT&T served 48 percent of enterprise long-distance and data services, while MCI accounted for another 31 percent.[14]

12. Consequently, AT&T and MCI require extensive facilities for the carriage of long-distance and data traffic onto their long-haul voice and data backbone networks, particularly from enterprise businesses in metropolitan markets. To a considerable degree, AT&T and MCI have deployed such facilities themselves. In addition to its nearly ubiquitous long-distance network, for example, AT&T operates "one of the largest IP networks in the U.S.," has deployed "numerous VoIP gateways" nationwide, and offers business customers "over five thousand WiFi locations in more than 50 countries."[15] Similarly, MCI highlights that its "IP network is one of the world's largest and fastest, with connectivity to more than 2,700 cities in more than 200 countries across six continents."[16] As will be discussed below, AT&T and MCI have also invested heavily – both in new construction and through their acquisitions of such competitive access providers as Teleport (AT&T), MFS (MCI), and Brooks Fiber (MCI) – to deploy local facilities for switching, interoffice transport, and end user access throughout the United States. Despite their considerable local presence, however, AT&T and MCI cannot duplicate the ubiquitous coverage of incumbent local exchange carriers, and both firms rely heavily on the ILEC for special access circuits to reach end user premises and to transport traffic to their various points of presence.

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[14] Jeffrey Halpern, Bernstein Research, *U.S. Telecom: Superior Growth Prospects Market a Key Battleground for U.S. Service Providers* (Jan. 6, 2005), at 12. Bernstein estimates for 2005 have AT&T's share increasing to 46 percent and MCI's decreasing slightly to 28 percent. See Jeffrey Halpern and Shing Yin, Bernstein Research, *A Tough Nut to Crack III: Consolidation Bypasses Inexorable Share Shifts* (Aug. 2005), at 19.

[15] AT&T 2004 10-K, at 6.

[16] MCI, Inc., Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2004 (S.E.C. Mar. 16, 2005), at 11.

13. Clearly, carriers purchasing the largest number of special access circuits from ILECs are the ones potentially most affected by FCC rules allowing the conversion of special access circuits to UNE rates. While the total number of special access circuits procured nationwide by individual carriers is generally not readily available, there is little dispute that AT&T and MCI are far and away the largest purchasers of wholesale special access services from incumbent local carriers. Consequently, the potential impact of the Commission's circuit flipping rules with respect to AT&T and MCI is much larger in absolute terms than with respect to other carriers.

14. While nationwide totals regarding the special access purchases of AT&T and MCI are not readily available, I have been granted access to Qwest confidential data that summarize Qwest's provisioning of DS1 and DS3 special access circuit counts and revenues within the Qwest region. These data confirm that AT&T and MCI are by far the largest purchasers of DS1 and DS3 special access circuits within the Qwest region. **[**BEGIN CONFIDENTIAL**]**

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[17] The source for these data is Qwest Communications, Inc., "DS1 RCP Expiration Report – April 30, 2005" (May 5, 2005) (hereinafter "Qwest RCP Report"). **[**BEGIN CONFIDENTIAL**]**

[END CONFIDENTIAL**]**

[18] **[**END CONFIDENTIAL**]** It should be noted that these revenue totals reflect the fact that the AT&T and MCI circuits were procured from Qwest pursuant to that carrier's Regional Commitment Plan, which is a "volume- and term-commitment plan available to customers in the interstate tariff" that "offers customers a 20 percent discount" off of the tariffed rate for a term of 48 months.[19]

15. As the data show, AT&T and MCI together account for **[**BEGIN CONFIDENTIAL**]**

[END CONFIDENTIAL**]** The large volume of special access purchases from Qwest represented by AT&T and MCI suggest that, all else equal, one would expect the FCC's rules regarding the conversion of circuits to UNEs to have a pronounced effect on these carriers relative to other purchasers of special access. As a practical matter, however, other characteristics of AT&T and MCI (particularly in light of their proposed mergers to SBC and Verizon) magnify the potential impact of the Commission's circuit flipping rules on these carriers. In other words, the ability to convert special access circuits to UNE rates disproportionately affects AT&T and MCI. As will be discussed below, these carriers' leading positions in long-distance and data markets, as well as their considerable presence nationwide as facilities-based providers of wholesale and retail local telecommunications, entails that AT&T and MCI have the potential to benefit hugely from the conversion of special access circuits to UNEs, a potential that is not shared by any other carrier.

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[18] *See* Qwest RCP Report.

[19] Qwest Communications, Inc., "Large Business: DS3," http://www.qwest.com/pcat/large_business/product/1,1016,141_4_2,00.html (visited Sept. 29, 2005). See also Qwest Communications, Inc., "Partners: DS1," http://www.qwest.com/pcat/partners/product/1,1016,140_6_9,00.html (visited Sept. 29, 2005).

ii. AT&T and MCI Have Extensive Local Facilities

16. It is well recognized that, as a competitive provider of local wholesale and retail telecommunications services, AT&T has one of the largest facilities-based presences throughout the United States. As reported by AT&T in its most recent 10-K filing with the Securities and Exchange Commission ("SEC"), AT&T's domestic network as of year-end 2004 included 21,655 route miles of metropolitan fiber and 692 points of presence, serving "the majority of U.S. business centers."[20] According to AT&T's 10-K filing, the carrier operated 156 local switches in 91 U.S. cities, reaching nearly 7,000 buildings through more than 8,600 metropolitan synchronous optical network ("SONET") rings.[21] MCI does not report such statistics for its domestic U.S. network in its most recent 10-K filing with the SEC. Instead, the carrier describes its global network as a whole. Nevertheless, it is apparent from MCI's description of its worldwide network that the carrier has in place extensive metropolitan facilities, featuring widespread local switches and connections to thousands of end user buildings, in "all major United States and key international cities."[22]

17. Because special access rates available to smaller competitors are generally considerably higher than those available to the largest carriers, as a result of the smaller carriers' inability to meet eligibility requirements for term or volume discounts from the ILEC, a

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[20] AT&T Corp., Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2004 (S.E.C. Mar. 10, 2005), at 5 (hereinafter "AT&T 2004 10-K"). AT&T has apparently also recently completed the construction of an additional 14,838 route miles of new fiber cable "capable of carrying 40 gigabits per second when that technology is commercially available." *Ibid.*

[21] AT&T 2004 10-K, at 6.

[22] *See* MCI, Inc., Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2004 (S.E.C. Mar. 16, 2005), at 11 ("As part of our overall network, we have an extensive metropolitan network of over 13,000 route miles serving customers in all major United States and key international cities. We have local-to-global-to-local connectivity to over 100,000 buildings (with over 8,000 buildings directly connected to our network and approximately 92,000 indirectly connected). Deployed in business centers throughout the United States, Western Europe, the United Kingdom, Japan, Australia and Singapore, our local networks are constructed using closed-loop self-healing fiber rings.").

substantial wholesale market has developed for procuring these circuits from carriers that can obtain substantial discounts from the incumbent or that can provision the underlying facilities themselves. My understanding is that, by far, the two largest non-ILEC suppliers in these wholesale markets are AT&T and MCI. That is, AT&T and MCI are direct competitors with the ILEC for its special access business. This is not surprising given the extent of these carriers' local facilities, as entrants that have deployed their own local facilities in competition with those of the ILEC have an incentive to participate in the wholesale market in an attempt to fill their unused capacity with the traffic of other, non-facilities based carriers. Not only are AT&T and MCI the nation's largest purchasers of special access, therefore, they are also the leading sources of competition to ILECs for the provision of wholesale local access and transport circuits.

iii. Implications of the Circuit Flipping Rules for AT&T and MCI

18. As was discussed above, the FCC does not make UNE treatment available to circuits over which interexchange or wireless services are solely provided. Instead, UNE rates are available only to carriers and circuits that qualify as providing competitive local telecommunications services. Thus, at least some local service traffic must be carried on a special access circuit in order for it potentially to be eligible for conversion to UNEs. Consequently, the widespread presence of AT&T's and MCI's local switches and their ability to offer local wholesale and retail services is highly relevant to the discussion of circuit flipping, particularly in light of these carriers' other role as major purchasers of special access circuits to support their long-distance and data businesses. Far more than any other carrier, AT&T and MCI have the ability to route local traffic onto the special access circuits they currently use exclusively for long-distance services. Their pending consolidation with SBC and Verizon, the largest incumbent local carriers in the country, only increases further their access to local service

traffic and their ability to route it onto their existing special access circuits. AT&T and MCI are highly positioned – indeed, once the mergers are effectuated, they will be uniquely positioned – to qualify to convert their large bases of special access circuits to UNE rates.

19. With the approval of the mergers, AT&T and MCI will almost overnight gain the windfall ability to switch from special access rates to UNE rates on a substantial portion of the circuits they rely upon to provide local, long-distance, and data services. Competitors in these markets will not have the opportunity to do likewise. The Commission's circuit flipping rules thus benefit AT&T and MCI disproportionately, having a far greater effect than would be explained by the volume of these carriers' special access purchases alone.

20. One implication of this is that AT&T and MCI may suddenly find themselves facing "negative" marginal costs on a substantial portion of their network. That is, the prices paid by these carriers to the ILEC to procure local access or transport circuits, which is an input cost to the provision of whatever service AT&T or MCI ultimately provide to customers over those circuits, will be cut dramatically by substituting UNE rates for those of tariffed special access. Indeed, as I discuss elsewhere in this Declaration, UNE rates tend to be approximately 50 percent of the ILEC's special access tariff. (Specific figures for the Qwest region are provided below.) In effect, the cost faced by AT&T or MCI when bringing a new circuit for the provision of competitive local service into operation will be *less than zero*, since the carrier will have the opportunity to pay the UNE rate but forego the much higher special access rate. Again, this benefit will not be available to other carriers. For CLECs other than AT&T and MCI, procuring a new local circuit will entail a positive cost – such as acquiring one's own local switching facilities in each market. My understanding is that none of Qwest's out-of-region

circuits are eligible for flipping. In Section III, I will discuss further the role of AT&T and MCI as "inframarginal" sources of supply.

iv. Quantifying the Potential Impact of Circuit Flipping on Qwest

21. **[**BEGIN CONFIDENTIAL**]**

[END CONFIDENTIAL**]** Using these data and the carrier-specific totals reported by Qwest, one can estimate the maximum amount of special access revenue at risk from the ability of carriers to convert special access circuits to UNE rates.

22. I have been provided by Qwest with estimates of the percentage differences between DS1 and DS3 UNE rates within its region and the special access rates it offers carriers under its standard private line telecommunications service ("PLTS") tariff or under its discounted Regional Commitment Plan. Table One below summarizes the data I received. As the table shows, Qwest has estimated UNE and special access rates at an aggregate level across its whole service territory and has reported UNE rates as a percentage of the (higher) special access price. **[**BEGIN CONFIDENTIAL**]**